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MONOPOLY AND COMPETITIVE PRICES

Public policy toward the trusts in the United States has been and continues to be characterized by a marked difference of opinion. On the one hand we have those who believe that competition as a general regulator of industry has broken down and that, indeed, it is more or less "inevitable" that competition should break down, because it is believed to contain within itself the seeds of its own destruction. Those who thus mourn, or perhaps rejoice, over the assumed inevitable demise of competition make up a goodly company. President Van Hise in his book *Concentration and Control*¹ has much to say concerning the "breakdown" as well as the shortcomings of competition. Ex-President Roosevelt and the Progressive party generally were commonly assumed to accept industrial combination as inevitable if not socially desirable. Professor Jenks in his published writings and in his reported utterances seems also to consider that the "wastes of competition" and the "advantages of combination" unavoidably imply a supplanting of competition by combination. "Regulated monopoly" or something closely akin to it, according to this group, is the necessary solution of the trust question.

As against "regulated monopoly" we have those who deny the "inevitableness" of the breakdown of competition, and who, having faith in the beneficence and effectiveness of competition as a regulator of business, insist that the solution of the monopoly problem lies in the direction of rehabilitating and safeguarding competition. This view seems to have triumphed, at least temporarily, in the election of Woodrow Wilson and in the success of the Democratic party. There is not implied in it the assumption, made by some,² that pure-food laws and the prevention of misrepresentation and chicanery, as well as of the so-called "unfair" practices generally, involve any real limitation of competition, any more than a prohibition against direct stealing by one competitor from another is such a limitation. Indeed, those who look to competition rather than to "regulated monopoly" as the solution of the trust problem insist that the preservation of competition itself is inevitably dependent upon the suppression of what are termed the "bullying and browbeating" tactics that are believed to be chiefly

¹ The Macmillan Company, 1912. See *AMERICAN ECONOMIC REVIEW*, vol. III, p. 131.

² By President Van Hise, for example.

responsible for the destruction of competition in the past. In short, instead of "regulated monopoly" their slogan is "regulated competition."

Without attempting at this place to consider further the practical question of public policy in connection with the trusts, attention is called to the fact that the acceptance of the "inevitableness" of the self-destruction of competition involves a thoroughgoing modification of the currently accepted theory of competitive and monopoly prices. Indeed, the real purpose of this short article is to discuss critically an attempt made to supplant the currently accepted price theory by one modified to suit the exigencies of "regulated monopoly"; or, more specifically, by one that attempts to supply a theoretical basis for the "rule of reason" as applied by the Supreme Court to the interpretation of the Sherman anti-trust law.

The attempt here referred to is that made by Professor Frederick C. Hicks, of the University of Cincinnati, in a short pamphlet entitled *Competitive and Monopoly Price*.³ It is discussed at length because the theoretical propositions that Professor Hicks advances, or others similar to his, seem to be implied, even though they are not specifically formulated or expressly accepted, in the writings and utterances of those who advocate regulated monopoly.⁴ Professor Hicks writes so lucidly and succinctly that it is difficult to compress his argument more than he himself has done; but before the points he raises can be critically discussed it is necessary to set forth as faithfully as possible what those points are, how they are related to each other, and what their implication is.

The present trust policy of the United States, says Professor Hicks, is "an attempt to destroy monopoly and thereby leave the field to competitive industry." The explanation of this policy is to be found, he believes, "in an intuitive belief in the doctrine of fair price": this idea is practically universal and has existed for centuries even though, through changing economic conditions, the standard for determining fair price has itself changed. Today, he says, although no standard for determining fairness has been definitely formulated it is believed that fairness depends upon and follows as a matter of course from free competition, and practical

³ Frederick C. Hicks, *Competitive and Monopoly Price* (University of Cincinnati Studies, series II, vol. VII, no. 2. 1911. Pp. 39).

⁴ See, for example, Van Hise *op. cit.*, p. 85.

policy therefore sets up as its goal the suppression of monopoly and the maintenance of free competition.

Turning then to the current theory of price, Professor Hicks states that two sorts of price are recognized, namely, competitive and monopoly, and that corresponding to these are two classes of business, namely, competitive industries and monopolies. His further exposition of the generally accepted price theory may then be summarized as follows: Competitive price is the result of free competition and equals the cost of production. Besides actual outlays cost of production includes "normal profits," which may be considered to be of such an amount as to afford no "extra inducement to enter the business or leave it." If profits are abnormal there is a shifting of the factors under stress of competition until profits are restored to normal level. Monopoly price, on the other hand, is determined by largest net returns as influenced by elasticity of demand and by the various possibilities as to cost. The term monopoly lacks precise definition but it is generally understood to mean that "substantial unity of action" which gives the seller or sellers control of price. The significant thing, according to Professor Hicks, is that "*the fields of competition and monopoly are considered to be distinct.*"⁵

Professor Hicks then raises the question whether the theory as above outlined is "correct and satisfactory." He observes that the method employed to establish the truth of the theory is to show that under competitive conditions, price cannot remain permanently above or below cost of production; and that under conditions of monopoly, price cannot remain permanently above or below the point of maximum net profits. He then considers the current explanation as to *why* competitive and monopoly price cannot vary permanently from the levels thus respectively fixed for them. Taking up first the explanation of the influences that prevent prices from rising above these levels, he finds that in the case of competitive prices "competition" affords a sufficient answer. In the case of monopoly price, however, the current explanation is inadequate. What, he asks, is responsible for the falling off in sales that prevents monopoly price from advancing beyond the level of maximum net return? Current theory simply assumes the fact of falling off in sales without offering an adequate explanation as to why sales fall off. This explanation is, according to our author, that when prices advance too high purchasers turn to

⁵ Italics in original text.

other things, and the sellers of these other commodities, who are trying to attract customers, are, therefore, in essence rivals or *competitors* of the monopoly. For, adds Professor Hicks, "there is no difference *in kind* between the rivalry of those selling the same sort of goods and the rivalry of those selling different sorts of goods, so long as the rivalry results from the fact that each is trying to offer such attractive inducements as to lead people to buy his wares rather than the wares of the same or of different sorts offered by others" (p. 23). In other words, he maintains that in both competitive and monopoly prices it is *competition* which keeps price from going higher.

He turns next to the current explanation of the influences that tend to prevent competitive and monopoly prices from falling below their respective normals. Here, in the case of monopoly price, the power of the monopolist to adjust supply to demand is considered sufficient as an explanation. But it is now in the case of competitive price that Professor Hicks finds current theory wanting. The explanation usually given, he says, is that if competitive price drops below the normal some sellers will go out of business, production will be curtailed "and prices will go up." This is defective because price cannot of itself *go up*; it is *put up*. "So long as two competitors remain in the field *and continue to compete*, "price will continue to fall" (p. 26).⁶ Consequently, when price does not as a matter of fact continue to fall the inevitable conclusion is that competition as an effective force has ceased. But this again is no explanation of the "restoration of price" to the original normal. "If competition drives price below cost of production, price will move up, as has been said, only when it is put up, and *it will be put up only when there is such 'substantial unity of action' among those remaining in the business as to give a control over supply* sufficient at least to enable them to bring the price back again to its normal point" (p. 26).⁷ Professor Hicks is careful to point out the distinction between the fact of "substantial unity of action" and the method employed to bring it about. It may come about as a result of bankruptcy of the weaker competitors, of purchase, or of agreement; or it may come about "merely as the result of an independent recognition by each that he is a loser from unreasonable competition and will be a gainer by spontaneously acting in union with others" (p. 27).

⁶ Italics in original text.

⁷ Italics in original text.

In other words, according to Professor Hicks, just as it is competition which limits monopoly price so also is it monopoly or "substantial unity of action" that limits competitive price. It follows from this that competition and monopoly, instead of being distinct and opposing forces, are in reality simply mutually limiting forces that are jointly responsible for both competitive and monopoly prices.

Professor Hicks dismisses as "casuistical jugglery, worthy alone of the modern prestidigitator," the explanation that it is buyers' competition that brings competitive price back to normal after it has dropped below. If that were the explanation, he avers, it would be logical to argue that it is buyers' competition that raises prices when the monopolist reduces supply, and the conclusion would then follow that all prices, monopoly as well as competitive, are determined by competition. In so far as competition and unity of action are opposing influences in the determination of price, our author argues that they must be regarded either from the standpoint of buyers or from that of sellers, and that the particular standpoint adopted must, to meet the demands of logical consistency, be adhered to throughout the analysis. He himself, he says, adopts the standpoint of the sellers because that seems to be the more common way.

Finally, Professor Hicks takes up the question of the practical bearings of his criticisms and of his constructive suggestions. These are briefly as follows:

(1) Contracts and agreements which limit competition do not necessarily restrain trade in the long run. Unless competition were limited at the point "where its further action" would "result in loss to producers" (presumably this means at normal price), the ultimate outcome would inevitably be bankruptcy to all but the strongest; and the latter would then monopolistically control the field.

(2) There is no such thing as a natural law of competition. The natural results of competition "if left to itself, are its own destruction and public injury" (p. 34). Granting that normal price is a fair price, the only way that it can be realized is through a "*proper balancing of competition and unity of action, the former insuring fairness to the consumer, the latter insuring fairness to the producer.*"⁸

How is this balance to be secured? Under perfect fluidity of

⁸ Italics in original text.

capital, labor, and business ability, the balancing would be automatic and fairness would be assured; but under actual conditions, it is only that capital, labor, and business ability not yet employed in industry that is really fluid. This limited fluidity prevents price from rising much above normal, but it cannot prevent price from dropping below normal. Under such circumstances the "fairness" insured is only the fairness to consumers and not that to producers, and "no policy looking to fairness can be expected to succeed which does not provide fairness for the producer as well as for the consumer" (p. 36). In other words, "free competition" is not an adequate solution of the trust question, for competition must itself be limited by reasonable unity of action; and the task of the legislator and the administrator, in working out a sound policy, must be so to delimit the fields of operation of both these forces that neither can completely overwhelm the other.

With this outline of Professor Hicks's argument before us a critical examination of its main points may be considered in order.

The first point to be raised is Professor Hicks's criticism that current theory treats competition and monopoly as two distinct and opposing rather than as two coördinate and mutually limiting forces. In this connection it will be recalled that in the case of monopoly price Professor Hicks emphasizes the alleged fact that price is kept from going above the normal by the rivalry of the sellers of those goods to which a part of the income is diverted that would, at the normal price, have been expended for the monopolized goods. He asserts, in other words, that competition prevents monopoly price from going above the normal. Here two objections may be raised. The first is that the assimilation of what Professor Seligman calls "personal competition" and that which he calls "commodity competition" is confusing rather than helpful in so far as the monopoly problem is concerned. Commodity competition is just as potent in the field of competitive prices as it is in that of monopoly. It is not commodity competition that courts and legislators are trying to preserve. That nothing can seriously menace. It is "personal competition" that is the important competition from the point of view of the public; and in the great majority of cases that is the only kind of competition that is thought of when the word competition is mentioned. Nobody, for example, thinks of the various departments of the Wanamaker store as, in a business sense, in competi-

tion with each other. It may, therefore, be respectfully denied that as "business phenomena, there is no difference *in kind*"⁹ between commodity competition and personal competition.

The second objection is that what is alleged to be a fact is not necessarily a fact. The income that is withheld from the purchase of monopolized goods when the prices of these goods are above normal is not necessarily diverted to other goods at all. It is conceivable that the entire amount is simply saved. It may even be hoarded in the shape of money. Under such circumstances how could it be said that it was "competition" that put an upper limit on monopoly price?

It will also be recalled that in the case of competitive price Professor Hicks maintains that it is virtually monopoly, or "substantial unity of action," that prevents such prices from dropping below the normal level whenever they are prevented from so dropping, and that he dismisses somewhat scornfully the explanation that "buyers' competition" is the upholding force. Here again confusion must surely result from assimilating the action of competing sellers in stopping price cutting at the point of loss and that of the monopolist who is adjusting supply in order to obtain "normal" monopoly price. After all, competition is at bottom a state of mind, and it is submitted that the state of mind that lies behind whatever "unity of action" is implied in the maintenance of normal competitive price is vitally different from that which lies behind the "unity of action" responsible for the maintenance of normal monopoly price.

And in this connection it must also be asked, why does "logical consistency" require that, in so far as competition and monopoly are opposing forces, they must be viewed *either* from the standpoint of buyers *or* from that of sellers? "Logical consistency" in theory demands only truth, and hence the question is simply whether there is or is not competition among buyers as well as among sellers. Is there not competition among buyers at an auction sale?¹⁰ Or, to take the situation in the speculative markets where competition is usually said to be least impeded, is there not competition among buyers there? In any market do not changes in the number and level of offers to buy have relatively the same effect on price as similar changes in the offers to sell? It is true

⁹ Italics in original text.

¹⁰ Whatever be the situation on the supply side it does not, of course, alter one way or another the fact of competition on the demand side.

that as industry is now organized sellers in their search for money profits for the most part name prices to begin with and seek eagerly after purchasers, but unless there be competition among buyers there is no more reason why all sellers should be able to get a uniform "marginal supply price" than that, under the competition of sellers, all the buyers are compelled to pay only "marginal demand price."

This brings up Professor Hicks' next point that the "inevitable result" of competition is self-destruction, unless that competition is "restrained" at normal price. Can that be asserted as a general proposition? Does it hold good even as a limited proposition applying, however, to a majority of cases in industry? Does the mournful contemplation of President Van Hise and others of the ruins of competition in the past necessarily prove that the havoc must be attributed to something inherent in competition itself? Has it not been frequently shown in the past that competition is ultimately self-limiting only where increasing returns are operating, or where perhaps the nature of the industry is such as to require relatively huge outlays for specialized fixed capital or, finally, where, to start out with, competitors are very unevenly matched in strength? Competition does involve a progressive elimination of the unfit, but that is due to the fact that, after all, "normal price" is not static but dynamic, and competition is the most powerful of the beneficent forces that tend to make it so. Where increasing returns are wanting, where no expensive specialized forms of capital are essential, where competitors are not greatly unequal in strength, where none enjoys special privileges of any kind, and where, through legal enactment or public opinion, what Professor Seligman calls the "level of competition" can be maintained, there is no danger that the end of competition is self-destruction. In most cases in industry the law of diminishing returns would prevent such a *dénouement*. Too often in the past the so-called self-destruction of competition has been plain murder by those who sought monopoly power.

Finally, let us consider Professor Hicks's contention that the limited fluidity of the industrial agents insures "fairness" only to the consumer and not to the producer. Is this so? Does the withdrawal of capital, of labor, and of business ability from a given field have no effect on the entrepreneurs, capitalists, and laborers remaining in the field? Did not the option of "free land" in the West, exercised by a limited number of laborers, serve to

uphold the wage rate in the United States? Did not the exercise of this option also cause a great demand for capital that tended to maintain a high interest rate throughout the field of industry in this country? And did not the withdrawal of business ability from the sewing machine and other lines of industry into the automobile industry leave the competitive situation somewhat more comfortable for those who could not withdraw from the old lines? Surely an affirmative answer must be given to all these questions; and if the answer be in the affirmative, then the conclusion follows that in the majority of cases all that is necessary to insure "fairness" to the producer as well as to the consumer is to guarantee real freedom of competition.

Furthermore, it must also be noted at this point that the trust question is not only a question of the interest of the producer as against the interest of the consumer. It is, as well, a question of the interest of the entrepreneur as against the respective interests of capitalists, landowners, and laborers. And recognizing this simply strengthens the contention that "fairness" all around, except in the cases already allowed for, is most safely insured, within the rules imposed upon all by society, by the fullest freedom of competition.

In conclusion it must therefore be said that Professor Hicks has not given us a convincing theoretical basis for the "rule of reason," whatever may be thought of applying the "rule of reason" in the enforcement of the Sherman law. Indeed, the opinion may be ventured that any theory assuming self-destruction of competition as a general proposition is foredoomed to failure. Yet no student can read Professor Hicks's excellently written pamphlet without being grateful to him for his lucid criticism and his stimulating suggestions even though, as in the case of the undersigned, both the criticism and the suggestions provoke vigorous opposition.

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